

**Letter of Findings: 01-20170161
Income Tax
For the Years 2013-15**

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Individuals did not establish that they had no additional Indiana income during the tax years. Therefore, the Department's assessments for additional Indiana income tax were not proven incorrect. Penalties were abated.

ISSUES

I. Income Tax—Imposition.

Authority: IC § 6-3-2-1; IC § 6-8.1-5-1; *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Indiana Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayers protest the imposition of Indiana individual income tax.

II. Tax Administration—Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayers protest the imposition of penalties.

STATEMENT OF FACTS

Taxpayers are a married couple and are Indiana residents. As the result of a sales tax audit of a business ("Business") owned by Taxpayers covering the tax years 2013, 2014, and 2015, the Indiana Department of Revenue ("Department") determined that the business had additional income from underreported sales. The Department issued proposed assessments for additional sales tax and interest to Business. Since the business was a pass-through entity, the additional income from the additional sales was passed to Taxpayers. The Department therefore issued proposed assessments for additional Indiana individual income tax, penalties, and interest for the tax years. Separately, Business protested the proposed assessments of sales tax on the grounds that no additional sales had occurred. Business' protest was denied in Letter of Findings 04-20170160. In the instant Indiana individual income tax protest, Taxpayers protested that the business did not underreport sales and that there was no additional income to pass-through to them. An administrative hearing was held via telephone and this Letter of Findings results. Further facts will be supplied as required.

I. Income Tax—Imposition.

DISCUSSION

Taxpayers protest that they did not have additional Indiana individual income during the tax years 2013-15. The Department based its determination that additional tax was due on the determination that Business had underreported sales during those years and that the additional sales resulted in additional income which passed-through to Taxpayers. Taxpayers based their protest of the individual income tax assessments on the ground that Business did not have additional sales or income to pass-through to them.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the

person against whom the proposed assessment is made." *Indiana Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[w]hen [courts] examine a statute that an agency is 'charged with enforcing. . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, all interpretations of Indiana tax law contained within this decision, as well as the audit, shall be entitled to deference.

The Department refers to IC § 6-3-2-1(a), which states:

Each taxable year, a tax at the following rate of adjusted gross income is imposed upon the adjusted gross income of every resident person, and on that part of the adjusted gross income derived from sources within Indiana of every nonresident person:

- (1) For taxable years beginning before January 1, 2015, three and four-tenths percent (3.4[percent]).
- (2) For taxable years beginning after December 31, 2014, and before January 1, 2017, three and three-tenths percent (3.3[percent]).
- (3) For taxable years beginning after December 31, 2016, three and twenty-three hundredths percent (3.23[percent]).

Therefore, if a taxpayer has income derived from sources in Indiana, that income is subject to income tax. In this case, the Department determined that Taxpayers had additional income via income which flowed through from Business.

Taxpayers base their protest in this case on Business' protest in a separate case. The Department held a separate hearing and wrote a separate Letter of Findings for Business' protest. The Department denied Business' protest in Letter of Findings 04-20170160. Therefore, since the Department has denied Business' protest and since Taxpayers' protest is wholly dependent on the outcome of Business' protest, Taxpayers' protest is also denied. Taxpayers have not met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayers' protest is denied.

II. Tax Administration–Negligence Penalty.

DISCUSSION

Taxpayers protest the imposition of penalties pursuant to IC § 6-8.1-10-2.1. Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. [45 IAC 15-11-2\(b\)](#) clarifies the standard for the imposition of the negligence penalty as follows:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at [45 IAC 15-11-2\(c\)](#) as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;

- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayers protest the Department's assessment of penalties. Taxpayers state that they at all times exercised the level of reasonable care, caution, and diligence expected of an ordinary taxpayer. After review of the documentation and analysis provided in the protest process, the Department agrees with Taxpayer's position. While Taxpayer has not been sustained on the imposition of Indiana individual income tax in Issue I above, Taxpayers also established that Business had been audited before with no changes and so Taxpayers thought that Business was in compliance with its Indiana tax duties. Therefore, waiver of penalties is warranted under [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest to the imposition of penalties is sustained.

SUMMARY

Taxpayer is denied in Issue I regarding the imposition of Indiana individual income tax. Taxpayer is sustained in Issue II regarding the imposition of penalties.

Posted: 01/31/2018 by Legislative Services Agency
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